

**COMMENTS OF THE DIRECT ENERGY SERVICES, LLC
ON THE GOVERNOR'S SENATE BILL NO. 843, "AN ACT CONCERNING
REVENUE ITEMS TO IMPLEMENT THE GOVERNOR'S BUDGET"**

Direct Energy Services, LLC ("Direct Energy"), one of the largest integrated retail energy providers in North America, submits these comments in support of supporting Sec. 19 of S.B. 843. Direct Energy is a registered natural gas and electricity retailer in Connecticut. We serve customers in a total of 14 states, the District of Columbia and five Canadian provinces. We offer electricity, natural gas and energy management solutions to residential, commercial, and industrial customers. Direct Energy is an affiliate of the Direct Energy family of businesses that together serves over six million customers across North America. Direct Energy is wholly-owned by Centrica plc, one of the world's leading integrated energy companies. Centrica plc operates in seven countries and employs more than 34,000 employees worldwide.

Direct Energy strongly supports the proposal in the Governor's budget to move the remaining standard service customers to the competitive market in an orderly manner that ensures near-term benefits for customers and the State and longer-term benefits for the entire Connecticut economy. The evidence shows that (1) the Connecticut market is ready for this transition, (2) the Governor's proposal is an efficient and effective means of making this transition, and (3) the electric market in Connecticut after the transition is made will be better positioned to be a driver of long-term economic development than it is today.

1. The Market Is Ready For This Transition

The electricity market in Connecticut is one of the most mature among the restructured states. The number of customers and the amount of load served by retailers statewide amply demonstrate this fact.

- 45 percent of residential standard service customers, accounting for 49 percent of the load, are on competitive supply;
- 61 percent of standard service business customers, accounting for 82 percent of the load, are on competitive supply;
- In total, 47 percent of standard service customers, accounting for 62 percent of the load, are on competitive supply; and
- 47 percent of all customers of the State's two investor-owned utilities, accounting for 69 percent of the load, are on competitive supply.

Moreover, migration numbers have held steady or even increased as the standard service price has steadily declined. The reality of the situation is that a substantial majority of the standard service load has migrated to competitive suppliers and shows no indications of returning in material numbers.

The State is also served by a broad range of retailers addressing all sectors of the market. About 40 retailers are actively serving customers in each of the CL&P and UI service territories. Competition among these companies is robust. In each of those service territories, 20 retailers had at least a 1.0 percent share of the switched market (by customer count) and the largest share held by any competitor is 16.6 percent in the CL&P service territory and 13.3 percent in the UI service territory. These companies also run the gamut from mass market-focused regional players to large, integrated national and international firms, like Consolidated Edison Solutions, Dominion Retail, Energy Plus (an NRG company), GDF SUEZ, Constellation NewEnergy, Hess Corporation, and Direct Energy itself.¹

With such a large and diverse group of retailers serving the majority of load in the State, it is clear that standard service in its current form is no longer necessary. The conditions that led to the establishment of the utility as the default option that would serve all or most of the customers in the state immediately following restructuring – a dearth of proven suppliers, uncertainty about the liquidity and operational capability of the wholesale market, unfamiliarity on the part of both utilities and suppliers with the operational requirements attending retail access – are no longer present. There is no question that the current array of suppliers, and others that may enter the Connecticut market, are more than capable from an operational, financial and managerial perspective of serving all of the customers in the state.² ISO New England has been in operation for 15 years, and the wholesale markets it operates are very liquid and robustly competitive. The State's investor-owned utilities and competitive retailers work together seamlessly, identifying operational issues quickly and resolving efficiently through the EDI working group and the many individual relationships that have developed among them over the past 15 years.

Perhaps more so than any other state that has maintained a hybrid retail electric market (in which the utility continues to provide bundled commodity and distribution service to end use customers), Connecticut is well-positioned to take the next step toward a fully competitive retail market, and the Governor's budget proposal provides an ingeniously straightforward and effective way to make that transition.

2. The Governor's Proposal Will Benefit Customers and the Market Generally

In recent years, a number of other states (most notably Pennsylvania, Ohio and Illinois) are considering or have considered various mechanism to take their retail energy markets to the next stage of their development. In our view, the Governor's proposal is the most efficient and effective means of doing so, and is the one that will bring the greatest benefits to customers and to the market generally. This is the case for several reasons. First, it provides immediate benefits in the form of near-term rate relief to the customers

¹ The combined market capitalization of the integrated firms to which those seven companies belong (\$180.12 billion) is greater than the GDP of 26 states and the District of Columbia.

² An equally broad group of retailers, including many of those serving Connecticut customers, now serve more than 2 million customers in Pennsylvania, or about 500,000 customers more than in all of Connecticut.

who would be transitioning away from standard service. This represents tens of millions of dollars that will stay in the local economy.

Second, the Governor's proposal would capture the value inherent in the standard service customer relationships and make productive use of that value. When Connecticut restructured its electric market 15 years ago, all customers remained with the utility, which neither paid for the right to continue providing commodity to those customers nor enjoys any return on the commodity service it provides. Since then, retailers have spent many millions of dollars winning those customers away from the utility one at a time. While this approach has been effective in moving a great number of customers away from the utility (and also benefits some entities involved in the marketing of electricity), it has still left a tremendous amount of value trapped in a state of suspended animation. The Governor's proposal neatly captures that value for productive use by giving retailers a means of scale customer acquisition. Rather than going to marketing vendors for use in overcoming the inertia that has kept customers with the utility, retailers will pay what they otherwise would have paid in customer acquisition costs to the State, to use at it sees fit.

Finally, because the retailers will have an opportunity to acquire customers at scale, they will be much more likely to invest in innovative products and services that will allow them to keep the customers they have acquired. There is no absolute scale for determining at what point competitive companies will expand their investments in the Connecticut market, but there is no question that in making a commitment to move essentially all of its customers onto competitive supply, Connecticut will quickly rise to the top of the list of attractive places to invest in energy technology and operations. Due to the robust level of retail competitive already present in Connecticut, firms that acquire customers through the proposed approach and do not continue to offer competitive pricing and compelling products will lose those customers to other retailers. We have seen just this dynamic in jurisdictions (like Texas and the United Kingdom) that have made the full transition to a competitive market by greatly reducing or even eliminating the utility's role in providing commodity service.

This positive feedback loop contrasts sharply with that of the existing system of standard service. Utilities earn no return on the service they provide to these customers and thus have little or no incentive to innovative. Electricity commodity service is simply not among their core functions. They will never invest in it at the same level and in the same ways that competitive retailers will. This is not meant to be a criticism of the utilities; it is merely a recognition of the reality of where they earn a return. At the same time, the core functions on which they do earn a return – transmission and distribution services (including metering) – will require a high level of investment in coming years. The vestigial commodity function they serve only distracts them from the work they need to do to continue to improve their delivery systems, including (we hope) a build-out of the smart meter infrastructure that will be needed to ensure the reliability and efficiency of Connecticut's electric market in the decades to come.³

³ We would also note that the need for infrastructure improvements is not limited to the electricity sector. The Governor's Comprehensive Energy Plan identifies expansion of the natural gas system, including the

3. The Governor's Proposal Will Make the Electric Market an Engine of Economic Development in Connecticut.

The innovation and investment that the transition toward a fully competitive market will bring will be used for much more than allowing retailers to retain the customers they have acquired. It is the key to an essential part of Connecticut's economic future. Connecticut has been among the leaders among the State's in promoting energy efficiency and alternative means of producing energy. The State has also been effective at assisting ISO New England in addressing the serious capacity shortage the State faced in the middle of the last decade. The careful work of the regulators and the Administration has provided the State an excellent foundation for its energy future. But programs designed by the State and implemented through the utilities can only get the State so far; the real promise of this future can only be realized with the robust participation of the competitive retail and wholesale markets. For example, demand response and customer-side generation in all their forms present a wide and complex array of potential opportunities for customers – including residential customers – to take full control of their energy consumption, for their own benefit and for the general benefit of all users of the system. Taking the various available technologies (including smart meters, smart appliances, smart thermostats, roof-top solar, micro-combined heat and power, and plug-in hybrid and all-electric cars) and matching them with the individual needs and interests of Connecticut's million and a half electricity customers is the kind of infinitely complex puzzle that competitive markets are uniquely equipped to solve.

The states that recognize this need for the dynamism of the market in their electricity sector will be the ones that see the greatest results from it. There can be no clearer statement of such recognition than the transition away from the current approach to standard service proposed in this budget. The results will include:

- Downward pressure on the costs embedded in the electric system, as retailers drive internal efficiencies to help them better compete;
- Downward pressure on wholesale prices, which will benefit every customer, as retailers offer more customer-friendly and easily adaptable demand response options, flattening the overall load shape of the system and shaving off the highest cost hours;
- Downward pressure on individual customer bills, as retailers devise products and services that fit customers' individual needs and allow them to reduce their consumption and peak demand without a material change in lifestyle;⁴

ability to serve many more retail customers who are now using high-priced oil products to heat their home, as a key feature. Because both of the State's investor-owned electric utilities are part of integrated companies that also include the gas local distribution companies, the responsibility to accomplish this expansion will also fall to them. Clearly the State's utilities have a great deal of important work to do without the distraction of remaining in a part of the market where they no longer serve an essential purpose.

⁴ Direct Energy has begun offering such products in service territories with the most competition-friendly infrastructure and regulatory regimes. For example, we offer "Free Power Saturdays" and "Any Day Free" to customers in the PPL service territory in Pennsylvania, which has 100 percent smart meter penetration. We also offer "Power to Go," a prepaid product with no deposit (and which includes "Free Power

- Improved economic performance and job creation as the downward pressure on prices controls businesses' energy costs and defers the need for new generating capacity; and
- Additional job creation in the energy sector itself, as new ventures that were previously not viable become cost-effective due to the larger scale of the switched market in Connecticut, and retailers identify Connecticut as a place to test new products and services.

Furthermore, all of these benefits will be brought about without additional risk to ratepayers. Unlike the regulated utilities, competitive retailers understand that they must put their own capital at risk to devise new and innovate retail products and services that will allow them to retain their existing customers and win new ones. If a new product does not work out for a retailer, the costs of that particular project cannot simply be recovered through some reconciling factor in a nonbypassable charge; the shareholder must absorb the loss.

The combination of these characteristics makes the Governor's proposal exactly the right thing at exactly the right time for the State of Connecticut, and we strongly support its inclusion in the budget.

Saturday") to customers in Texas, which also has 100 percent smart meter penetration, which is required operationally to implement such a product. Our preliminary analysis of these products shows that customers not only shift demand in response to such easily understood price signals (you can't get lower than "free" as an off-peak price) but also reduce overall consumption for a double-benefit to their household bottom line.